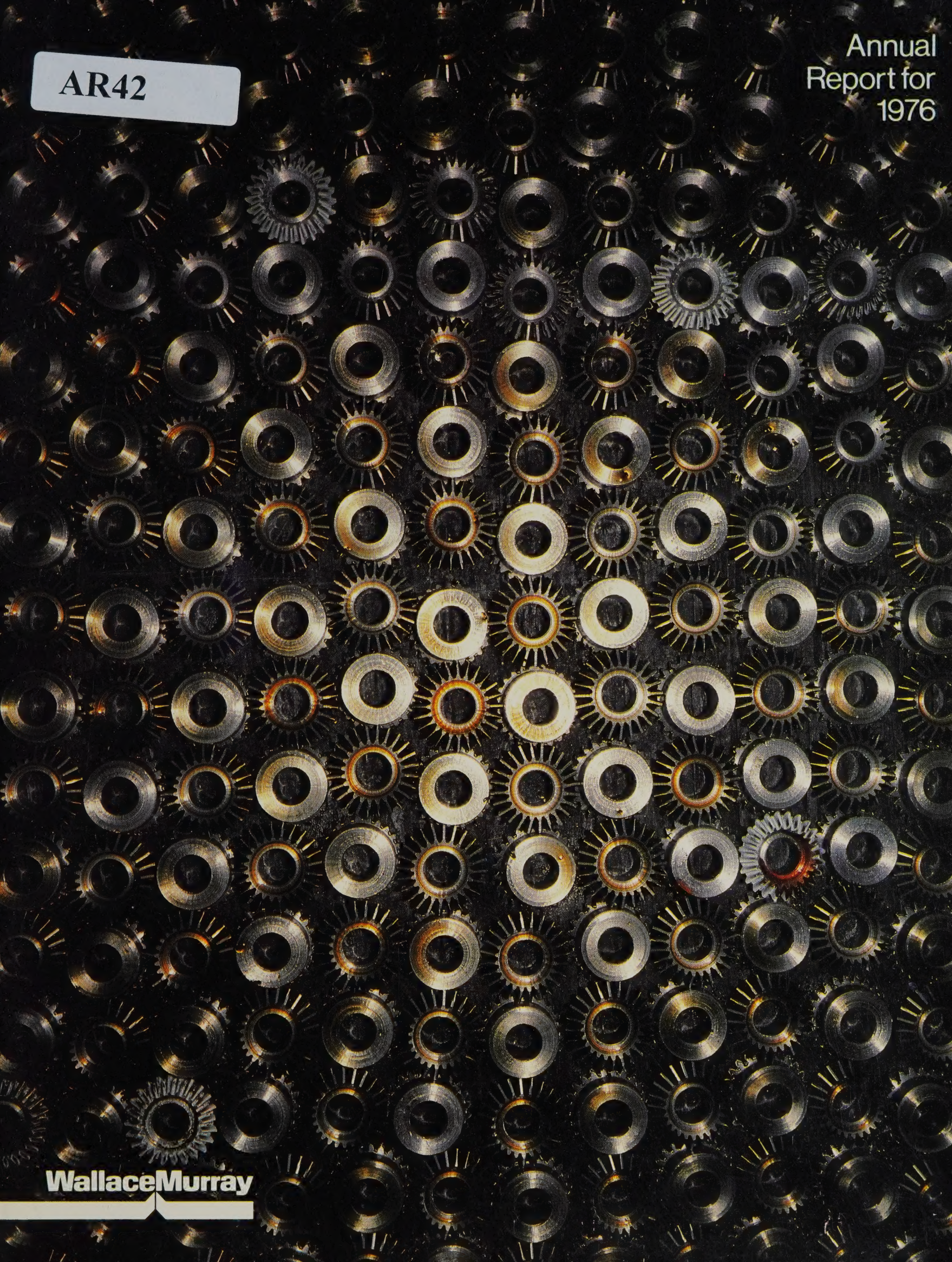
AR42

Annual Report for 1976



WallaceMurray

Highlights

	1976	1975
Net Sales	$337,327,000	$283,563,000
Income From Continuing Operations	19,374,000	12,885,000
Percent of Sales	5.7%	4.5%
Return on Average Stockholders' Equity	17.4%	12.4%
Loss Related to Discontinued Businesses	—	4,488,000
Net Income	$ 19,374,000	$ 8,397,000
Primary Earnings Per Share:		
Continuing Operations	$5.76	$ 3.65
Discontinued Businesses	—	(1.47)
Net Income	5.76	2.18
Fully Diluted Earnings Per Share:		
Continuing Operations	$3.94	$ 2.62
Discontinued Businesses	—	(.91)
Net Income	3.94	1.71
Funds Provided by Operations	27,361,000	16,526,000
Depreciation	6,810,000	7,496,000
Capital Expenditures	15,596,000	7,768,000
Working Capital	95,797,000	91,075,000
Long-Term Debt	53,492,000	58,097,000
Stockholders' Equity	119,616,000	104,848,000
Dividends Per Share of Common Stock	$ .90	$ .80

Cover: Pattern of stock gears represents one of the lines of products from the Ohio Gear Company, whose acquisition by Wallace Murray was one of the year's highlights.

To Our Shareholders

Since last year's annual report, your Company has experienced one of the most dynamic periods in its history. Wallace Murray had record earnings in 1976 for the second year in a row. They were up 50 percent on a 19 percent improvement in sales volume. The Company acquired Ohio Gear which broadens our product line in the power transmission field. We completed the divestiture of our metal stamping and industrial abrasive businesses, and in February of 1977, the Corporation carried out a successful tender offer for the stock of Hydrometals, Inc., a $120 million business synergistic with two of Wallace Murray's three principal businesses.

First, let us review the financial results of 1976. Net income amounted to a record $19,374,000 in 1976 as compared with income from continuing operations of $12,885,000 in 1975. Last year's net income was $8,397,000 reflecting an after tax loss from discontinued businesses of $4,488,000. Sales in 1976 were $337,327,000, compared with 1975 revenues from continuing operations of $283,563,000.

Earnings per share on a primary basis amounted to $5.76 in 1976 compared with $3.65 from continuing operations the prior year. Earnings per share on a fully diluted basis amounted to $3.94 versus $2.62 from continuing operations last year.

Net income in the fourth quarter was $6,304,000, up 42.4 percent from the $4,426,000 earned from continuing operations in the fourth quarter of 1975. Sales were $93,730,000, up nearly 23 percent from the like prior period of $76,237,000.

Earnings per share on a primary basis in the fourth quarter amounted to $1.91 in 1976, compared with $1.31 from continuing operations the prior fourth quarter.

Earnings per share on a fully diluted basis for the fourth quarter amounted to $1.28 versus 90¢ from continuing operations last year.

These record earnings are attributed to increased volume resulting from improved economic conditions and a continuing aggressive management approach to markets, planning and profit improvement. As the year progressed, the Company's building products and cutting tools operations became more important contributors to revenues and profitability. Power components, which had played such a significant role in last year's success, showed a slight decline in profitability.

In April, 1976, as noted above, Wallace Murray acquired Ohio Gear, Inc., a subsidiary of Caterpillar Tractor Co., for approximately $6 million. Ohio Gear is a manufacturer of a wide range of stock speed reducers and stock gears. Its projected contributions are detailed in the text that follows.

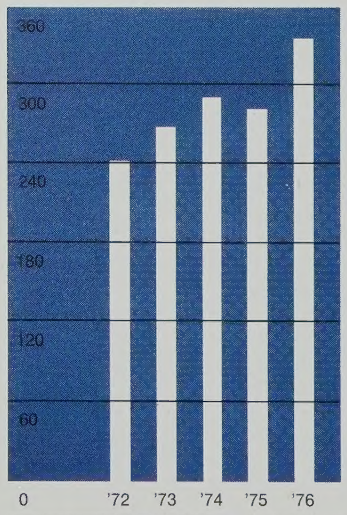
Two significant capital expenditures were made during the year. The first was the construction of a new plant for Metalbestos Systems in Nampa, Idaho, which has replaced their Belmont, California facility. The second involved the conversion of the Shreveport, Louisiana service center of Simonds Cutting Tools into the largest wide band saw manufacturing facility in the country.

In all, capital expenditures during 1976 amounted to approximately $15 million compared with depreciation of $6.8 million. We believe that this record level of capital expenditures will significantly improve the Company's productivity and profitability in the years ahead.

The final stage of the divestiture of Simonds Abrasive was completed in October, 1976 when the Canadian Foreign Investment Review Agency approved the sale of the Canadian abrasive business to Unicorn Abrasives of Canada, Ltd.

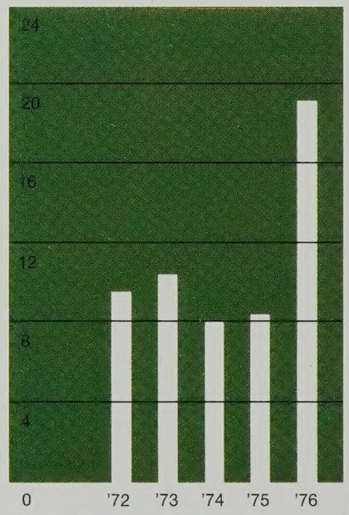
Net Sales*

in millions of dollars



Income*

in millions of dollars



*The sales, income and earnings chart presentations throughout the report exclude discontinued businesses for all periods.

On January 27, 1977, Wallace Murray, having purchased 350,000 shares of common stock of Hydrometals, Inc. (NYSE), announced a cash tender offer for any and all shares of the Company's stock. We are pleased to report that the offer, which received the unanimous approval of the Hydrometals Board of Directors, was successful and Wallace Murray owned as of February 16, 85 percent of Hydrometals common stock and 47 percent of its convertible preferred stock. The purchase was financed in part from internal funds and in part from short and long term borrowing.

Hydrometals had sales of $120,988,000 in fiscal 1976 (year ended September, 1976). Their principal lines of business are plumbing hardware, non-powered hand tools, and consumer electronic products, accessories and parts. Your management feels that this acquisition will provide an excellent extension of two of the principal lines of business and will be a significant factor in the increased growth of Wallace Murray in 1977 and in the years ahead.

There was a realignment of corporate management responsibilities announced in November and made effective January 1, 1977. Richard L. Durgin was elected a group vice president of the Corporation and put in charge of power components. Mr. Durgin had been vice president-general manager of the Illinois Gear Division for the last seven years.

Robert J. Niehaus, who had been group vice president-power components, was named group vice president in charge of the cutting tools group. He succeeds John C. Orr, who, because of the growing importance of the Company's cutting tools business in Canada, was reassigned to the position of vice president-general manager of Simonds Canada Cutting Tools.

Harold R. Falkner continues as group vice president of building products but he will assume the added responsibility for all Selkirk Metalbestos operations in Europe.

Six labor contracts were successfully negotiated during the year without a single labor stoppage.

In August, the Board of Directors announced a new quarterly dividend rate of 25¢ on the common stock. The effect was to bring the total annual dividend for 1976 to 90¢ versus the 80¢ paid in 1975.

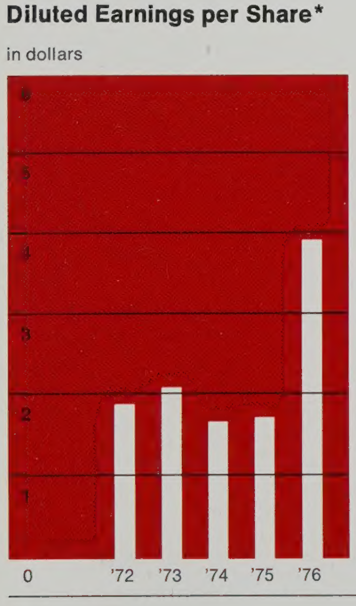
Looking ahead, the Corporation's programs anticipate earnings improvements in power components in 1977, continued improvement in both building products and cutting tools, and the added benefit of the Hydrometals acquisition. However, there are a number of significant labor contracts scheduled for renewal in 1977, and the full impact of energy shortages experienced by ourselves, our suppliers and our customers in the early part of the year cannot yet be fully assessed.

On behalf of the Board of Directors and officers, we wish to take this opportunity to express our sincere appreciation to our employees for the loyalty and cooperation they have demonstrated through the year. We also wish to acknowledge the valued support of our customers and suppliers, and to thank you, our shareholders, for your continued confidence and support.

CV Myers

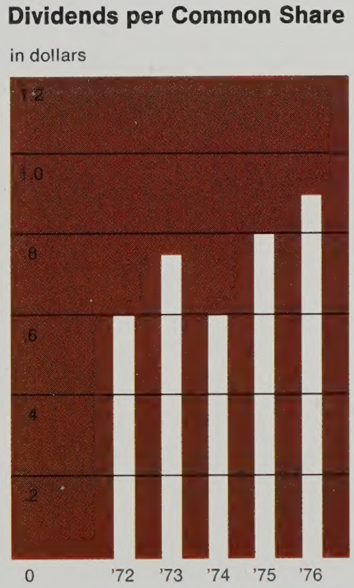
Charles V. Myers
President

Franklin H. Kissner
Chairman



Diluted Earnings per Share*

in dollars



Dividends per Common Share

in dollars

Building Products

Last October, we reported to you our plan to build a major new Metalbestos Systems manufacturing facility to be located in Nampa, Idaho to replace a smaller existing facility in Belmont, California. The division also has a second plant in Logan, Ohio. The photograph at right, taken on January 24, 1977, shows raw material and production equipment being installed in this new plant which is already in partial operation and should be completed by May of this year. This substantial expansion was occasioned by the continued strong demand for the existing Metalbestos chimney and gas vent systems, and by the need to provide manufacturing space for a new line of products which is now undergoing its final evaluation prior to being placed on the market.

The growing success of the Metalbestos products, which again recorded the best year in their history, is due to the broad technical knowledge which Wallace Murray has accumulated in solving problems related to the venting of heating systems for industrial, commercial, institutional and residential application. From the introduction in 1925 of the first gas vent to utilize the direct conduction of heat, to the present Metalbestos double-walled, freestanding stainless steel chimney, the Company has led its industry in the development of improved products.

One of the newest of these products is a line of built-in and freestanding fireplaces marketed in Canada. The built-in fireplaces are marketed through licensing arrangements in the United States. Attractive, easy to install, and unusually efficient sources of heat, these fireplaces are gaining wide, rapid acceptance with an energy-conscious public. Because they compete in a market where costlier, conventional masonry still accounts for some 90 percent of all new installations, they represent a promising opportunity for wider penetration, as well as the means of generating demand for additional Metalbestos products. Many homeowners are adding these fireplaces to existing homes, thus creating an additional market above and beyond the cycle of housing starts.

Eljer Plumbingware

Eljer is, by the nature of its products, essentially tied to residential construction activity. The fact that the level of this activity increased during the past year is reflected in the division's performance. Moreover, because there is a time lag between actual housing starts and sales of plumbingware, this stronger demand for Eljer products should continue to be felt throughout 1977.

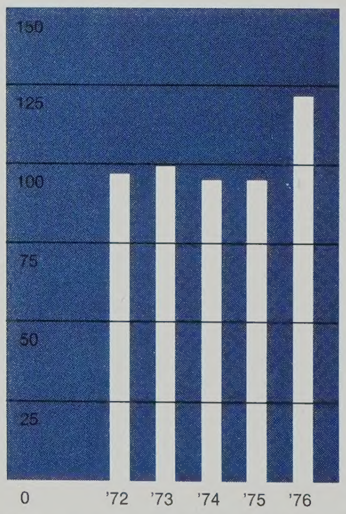
But even if the total size of its primary market is largely determined by forces beyond its control, there are still opportunities for Eljer to enhance its competitive position. It can, for instance, improve the quality and efficiency of its distribution network. In the past year, this program was advanced by the addition, on an exclusive basis, of several new wholesalers including a major new one in the suburban New York market.

The remodeling market offers another opportunity for Eljer, particularly as the cost of housing may prompt families to add facilities to their existing homes. As an initial step into this new field, Eljer has completed the development of the sales tools and materials required for the direct kind of marketing which characterizes much of home remodeling sales.

As a full-line producer of plumbing systems and fixtures, Eljer commands an unusually broad manufacturing capability in materials as diverse as cast iron, formed steel, vitreous china,

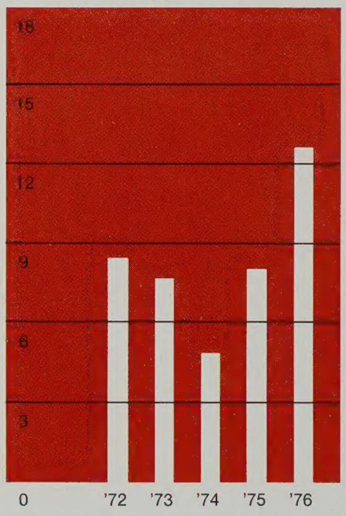
Net Sales*

in millions of dollars



Income Before Income Taxes*

in millions of dollars



Coils of raw steel are unloaded at the new Metalbestos plant in Nampa, Idaho as machinery for product lines is being set up in background. The plant, for which ground was broken in July, began to turn out finished product in January, 1977.

LIFTALL

fiberglass and brass. Still a third program is the evaluation of products new to the Company which, by virtue of these capabilities, Eljer can profitably produce and market.

Fiberglass Products

One example of the successful application of this strategy is Wallace Murray's growing participation in the manufacture of fiberglass components for use in water treatment plants, air pollution abatement systems, and industrial-chemical processes of many kinds.

This business, which had been growing rapidly, was somewhat affected during the past 12 months by the general softness in the industrial goods sector of the economy, but should see a renewal of activity in the year ahead. As it does, it will provide the building products segment of Wallace Murray's operations with still another field of activity beyond the conventional range of residential construction.

Lawton-Scharf

As a supplier of plumbing products and building components to the manufactured home industry, Lawton-Scharf is a specialist in a specialized business. The industry which it serves has had a cyclical history but, as *Business Week* noted last June, the rising cost of single-family houses has now provided it with "its best chance in its 40-year history to capture, or inherit, a substantial segment of the traditional housing market." The magazine further pointed out that a greater proportion of the industry's shipments in 1976 were in the costlier models. Anticipating this trend, Lawton-Scharf has expanded and upgraded its product lines.

Dry Manufacturing

Another specialized producer, Dry is one of the nation's largest manufacturers of registers, grills and diffusers for heating and air-conditioning. As a supplier to the commercial and residential construction industry, Dry enjoys unusually favorable regional positioning, placing all its activity within the fast-growing sun belt from Florida to California. The year's major development within the division has been the institution of increased mechanization, which has improved production efficiency and was largely responsible for Dry's having the highest net sales and net profit of any previous year in the division's history.

Selkirk Metalbestos-Europe

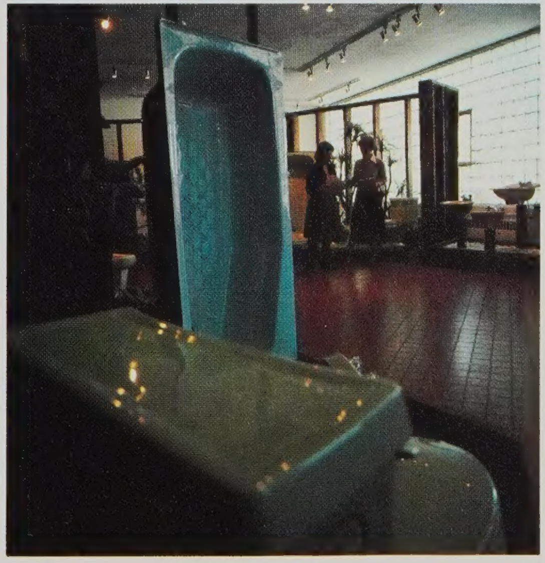
A record year was completed by Selkirk Metalbestos, along with important strides in achieving acceptance both in England and the Continent.

At the time that Wallace Murray built its plant in Barnstaple, England, we estimated that the total European market for residential and commercial construction was at least as large as that in the United States. We also noted, however, that the successful penetration of that market—or, more precisely, markets—was bound to be difficult, time-consuming and expensive. These problems are now well toward resolution, especially in the United Kingdom, Norway, Denmark, France and Germany. In some instances, Selkirk Metalbestos has been identified under existing codes as the sole accepted source. In others, we are still expanding our marketing programs to achieve better distribution. Exhibited at the 1976 Leipzig Fair, Selkirk Metalbestos products won a gold medal, and will be used in a large new East German sports arena. The Barnstaple plant has been expanded to two and one-half times its original size, and is presently being retooled to produce an improved line of gas vent systems.

Left: Skilled worker at Eljer's pottery in Tupelo, Miss. applies sticking dope to top surface of a toilet bowl prior to affixing the rim.

Right: Rectangular fiberglass chemical process tank receives a finishing coat. Circular shapes in back are dished heads for industrial tanks.

Far Right: Eljer distributors, such as Kingsway Supply in New York, offer consumers attractive displays.



Cutting Tools

Simonds Cutting Tools

For Simonds Cutting Tools, the past year has seen significant new developments in manufacturing, marketing, distribution and internal procedures—developments which together accounted for an earnings increase of 275 percent on a sales increase of 11 percent.

In August, production of wide band saws and large circular saws began at the Company's new plant in Shreveport, Louisiana (right). Complementing the new plant is a new service and distribution center which was moved from Shreveport to Greenville, S.C. This new plant and service center now permits Simonds to give complete attention to the needs of its major woodworking customers throughout the South. In addition, the more favorable energy rate structure will allow for more efficient plant operation, as electricity is a significant cost component in the manufacture of cutting tools. And finally, the existence of the new plant will make it possible to ease the load and simplify the operations of the principal Simonds manufacturing center in Fitchburg, Massachusetts, where these products had previously been made.

On a more far-reaching scale, the establishment of the Shreveport complex is part of an overall program to create a nationwide network of Simonds distribution points, service centers and manufacturing locations. The essential framework for such a system already exists, with facilities in Chicago; Los Angeles; Portland, Oregon; Fitchburg; Shreveport; Greenville; and Newcomerstown, Ohio.

Another important factor contributing to the improvement of Simonds profitability has been the success of the Company's comprehensive program of product pruning. Because cutting, slicing, shearing, scoring, slitting, filing and chipping are all fundamental manufacturing operations, and because Simonds has the capability to produce the tools needed to perform all of them, there is a virtually unlimited field of application for its products. By analyzing its output, which numbered more than 20,000 different items, and by matching against both present and anticipated needs, Simonds has been able to organize itself into 80 basic product lines, some 70 percent of which it now maintains as stock items, all without unduly losing competitive advantages. This new efficiency has in turn made possible a smoother order of scheduling, and far more responsive control of materials and inventories. At the same time, and with a complementary expansion of its computer controlled delivery system, it has enabled Simonds to improve customer service.

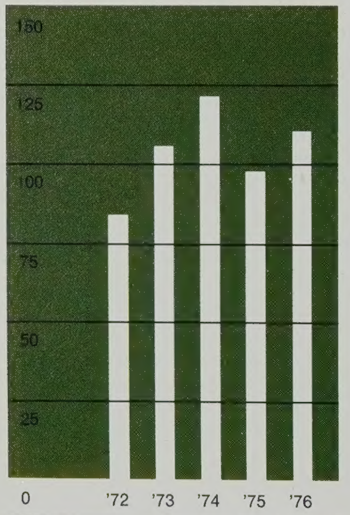
Research and Development

Simonds maintains one of the most extensive, advanced research and development programs to be found in its industry. In addition to metallurgists and specialists in stress analysis and heat treatment, for instance, its scientific staff includes an acoustical engineer—because noise is one of the inevitable by-products of operating saws at high speed. One of the recent products of this research group is a circular, toothed blade designed to cut a furrow in the ground, and thus make a bed suitable for seeding. A set of such blades, ganged on a tractor-driven soil reseeding machine, eliminates the need to plow and harrow the soil prior to seeding. Developed in cooperation with John Deere, Inc., and intended for use in forestry and the reclamation of pasture land, the blade, on which Simonds holds a patent, is now undergoing field evaluation.

Another product which has found commercial application is a new knife

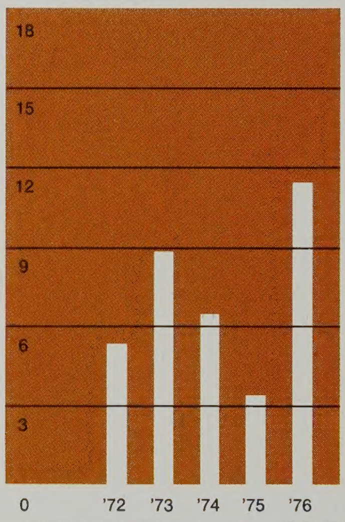
Net Sales*

in millions of dollars



Income Before Income Taxes*

in millions of dollars



Sparks fly as a wide metal band saw is sharpened at the new Simonds plant in Shreveport, La. prior to shipment to one of the lumber mills which is part of the South's rapidly growing woodworking industry.

intended specifically to cut sugarcane. The performance requirements for such a knife were high, and to a degree mutually exclusive. It had to have a long working life, and at the same time, in order to reduce waste, it had to make the narrowest cut possible. To produce the necessary configuration by conventional methods of metal forging or rolling was not practical. Simonds solved the problem by designing a knife which could be manufactured by investment casting. Because the best available tool tends to become the product of choice, there is a substantial market for the new knife. Of at least equal potential, however, is the possible application of investment casting, and its wider freedom of design, to other products.

Atrax

Wallace Murray's cemented carbide tool business has compiled an impressive year. Carbide, which next to diamond is the hardest substance known to man, has numerous uses in metalworking and the extractive industries, in automotive and railroad car building, in heavy construction, and in such energy related activities as oil exploration and drilling and coal mining where it assumes particular importance as it becomes necessary to sink deeper wells and to work more difficult veins. Under those conditions, a product which demonstrates consistently superior performance will rapidly gain a broad acceptance. This,on the basis of evidence to date, appears to be the case of a special Atrax carbide insert designed for use in the tri-cone bits extensively used in oil drilling. Formulated and processed to combine wear resistance and fatigue strength, the inserts have shown themselves clearly superior to competitive products by a factor of nearly 3 to 1, permitting one of Atrax's principal customers to take over major business in both Scandinavia and Africa. Other specialized Atrax Cemented Carbide products which are enjoying strong demand include the inserts for percussion mining and the coal industry, where increased activity is causing a change in traditional cost sensitivity.

Meanwhile, through Atrax Carbide Products, Wallace Murray continues to serve industry with solid carbide rotary tools. Again, energy and transportation related markets such as the automotive, electrical and bulk transportation industries, are important consumers for these products. The vertical integration of both Atrax units allows for tighter quality control, and contributes to the continued excellent reputation of Atrax products in their market places.

Simonds Steel

The strong recovery in automotive manufacturing, which uses specialty steels both for components and for production tooling, has provided the greatest support for Simonds Steel operations during the past year, and accounted for its substantial improvement in performance. Offsetting this favorable trend somewhat, aircraft and aerospace production remains at a low level, and sluggishness persists in the machine tool industry, traditionally a heavy user of specialty metals.

As a result of a program directed toward the development of more sophisticated products, Simonds Steel is now one of the leading suppliers of high reliability heat and corrosion resistant alloys for both military and commercial nuclear energy systems. Many projects relating to fissionable materials still await government or social sanction, but an increase in the tempo of both nuclear planning and the release of materials now appears to be developing.

Left: Atrax cemented carbide inserts, destined for use on rock bits, after being pressed into shape prior to sintering—heat treating.

Right: Incandescent coils of nickel-magnesium, chromium high-expansion alloy metal await annealing. Metal will be used as component in thermostatic controls.

Far Right: Finished band saws ready for crating and shipping at the packing end of the new Shreveport plant.

Power Components

Wallace Murray's long and fruitful participation in the power transmission industry was given important impetus this year by our acquisition of Ohio Gear, Inc.

Founded in 1915—just in time to produce shell casings for the Allied forces—Ohio Gear has over the years become specialized in speed reducers and stock gears, just as Wallace Murray's Illinois Gear has specialized in custom gears. The acquisition therefore not only adds substantially to our total business in power components, but it also broadens our base to encompass two new and important product categories. In addition, the new availability of capacity will permit us to accept orders which Illinois Gear, because of the nature of its productive facilities, has in the past been obliged to turn down.

Speed reducers of various ratios and configuration are used on a wide variety of mechanical equipment: farm machinery, conveyors, automotive assemblies, buses and other forms of transportation, hospital beds and X-ray equipment, crushing machines, food processing equipment, supermarket checkout counters, incubators, cranes and hoists. Ohio Gear produces speed reducers for these and other uses in capacities of up to 100 horsepower. It also has its own engineering staff to design custom reducers for special applications. The Company's plant in Liberty, South Carolina was built in 1964 and enlarged to its present 80,000 square feet four years ago.

Illinois Gear

After a protracted period of unusually heavy activity going back several years, Illinois Gear experienced a not unexpected moderation in demand during 1976. The chief reason for this appears to be a degree of uncertainty about the immediate future of the national economy, as reflected in a softer market for capital goods. There is, however, indication that a corner has now been turned. As of December, 1976, the three-month moving average for new orders at Illinois Gear reached a high for the year. Meanwhile, in some categories of special gears, the Company continues to work against a backlog of up to 40 weeks.

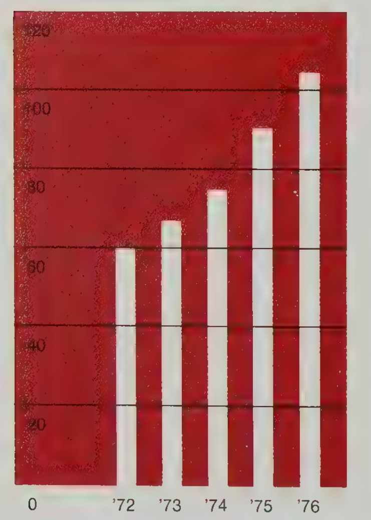
Schwitzer Engineered Components

Few products in any category are more directly relevant to current market demands—and national economic priorities—than Schwitzer's lines of engine components. Schwitzer is one of the largest manufacturers of heavy-duty diesel engine fans and a major factor in the automotive engine fan market. Most significant, however, in terms of volume, is the turbocharger, of which Schwitzer is one of the world's leading designers and manufacturers. Turbochargers increase the volume of air delivered to the engine's cylinders and thereby, with additional fuel mixture, increase the power output of internal combustion engines by as much as 100 percent, while at the same time improving fuel economy and reducing smoke emission—compelling technological breakthroughs.

Variable speed viscous fan drives and thermatic fan drives, which Schwitzer also makes in various sizes, automatically adjust fan speed to the engine's cooling requirements. Tests have demonstrated that in typical over-the-highway driving, the cooling action of the fan is needed only two percent of the time. Ninety-eight percent of the fan's operation serves only to waste fuel, make noise, cause wear and, in fact, degrade the engine's performance by taking heat out of it. A third group of Schwitzer products—automotive dampers—protect engine crankshafts by controlling torsional vibrations.

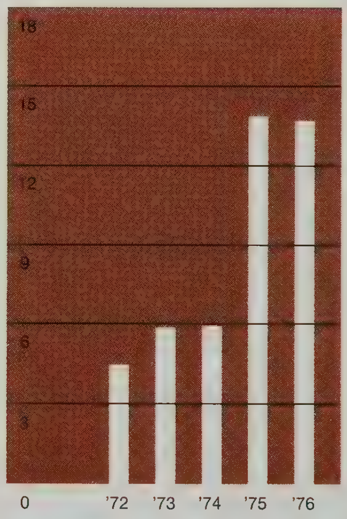
Net Sales*

in millions of dollars



Income Before Income Taxes*

in millions of dollars



Illinois Gear, part of whose varied output is shown at right, remains the leading U.S. producer of custom gears for virtually every kind of manufacturing and processing application.

The sales pattern of recent years suggests strongly that the advantages provided by the turbocharger have not been lost on either manufacturers or operators of diesel trucks. In 1975, production of heavy-duty trucks experienced the worst drop off in its history. This past year showed a moderate improvement of 17 percent. Nevertheless, because an increasing proportion of diesel trucks are being equipped with turbochargers, Schwitzer sales of this product have continued to be strong and, indeed, reached a record volume in 1976. With industry forecasts looking toward another 15 to 20 percent increase in diesel engine production for 1977, Schwitzer has now completed the second phase of a program to expand its productive capacity for turbochargers by 53 percent.

As the population of turbochargers in active use has increased—not only on highway vehicles, but also on construction equipment, farm machinery, industrial and marine engines, and stationary power sources—the demand for spare parts for rebuilding and for technical assistance has risen correspondingly. In 1976, Schwitzer strengthened its field sales organization to better serve the growing body of its customers. The Company's plant in Elwood, Indiana, which is the focal point for Schwitzer's service engineering activities, experienced the busiest year ever.

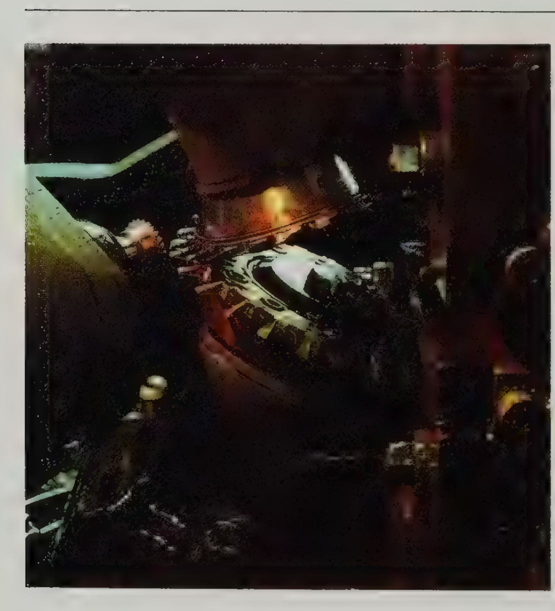
Fan drives offer many of the same advantages of more economical operation as do turbochargers, and moreover provide a means of achieving the noise abatement which is now the subject of legislative thrust. Because they are relatively new in the market place, however, there may well be insufficient familiarity with their performance. Another of Schwitzer's current marketing programs is a campaign of education-advertising to acquaint broader audiences with the operating aspects of fan drives, and especially their energy conserving potential.

International Operations

In 1975, Wallace Murray opened a service center in Leeds in the industrial Midlands section of England to satisfy the needs of turbocharger users. This center has grown to take on additional responsibilities for product rebuilding and a limited amount of remanufacturing. As of this year, it also extended its activities to such Commonwealth areas as Australia, New Zealand and Malaysia.

In Brazil, Lacom Componentes Industriais, S.A., a wholly-owned subsidiary of Wallace Murray, continues its planned evolution from a service and overhaul facility into an autonomous manufacturing operation. Under the impetus of strengthened local management and the removal of import restrictions for parts, the Company this year began working directly with original equipment manufacturers in South America.

In October, Wallace Murray announced the signing of a long-term license agreement with Pezetel, which is Poland's Foreign Trade Enterprise for the Aviation Industry. Under the terms of this agreement, which was approved by the Export Administration of the U.S. Department of Commerce, Poland will eventually be able to manufacture its own turbochargers from the Schwitzer design and as a result of engineering and training assistance. Through the agreement, Schwitzer turbochargers will soon be available for use on such European engines as Perkins, Leyland, Vauxhall, Steyr and Henschel. Negotiations leading to similar agreements are currently being carried on between Schwitzer and other Eastern European governments.



Far Left: Standard gear being cut on a Gleason Model 104 coniflex bevel gear generator at Ohio Gear's plant in Liberty, South Carolina.

Left: Diesel trucks, which represent a growing share of our national transportation fleet, are major users of Schwitzer's turbochargers and other engineered products.

Right: Technician monitors engine performance in one of the test bays of Schwitzer's recently completed laboratories.

Five Year Summary

Wallace Murray Corporation and Subsidiaries

Operations	1976	1975	1974	1973	1972
Net Sales	$337,327,000	$283,563,000	$292,360,000	$270,926,000	$241,723,000
Gross Profit	82,367,000	63,281,000	57,911,000	59,483,000	52,982,000
Operating Income	41,512,000	28,581,000	22,978,000	25,894,000	22,771,000
Interest Expense	4,563,000	4,650,000	4,662,000	4,461,000	4,606,000
Other (Income) Expense, Net	(825,000)	(1,454,000)	1,024,000	(885,000)	(329,000)
Income from Continuing Operations Before Income Taxes	37,774,000	25,385,000	17,292,000	22,318,000	18,494,000
Income Taxes	18,400,000	12,500,000	9,200,000	11,293,000	9,181,000
Income from Continuing Operations	19,374,000	12,885,000	8,092,000	11,025,000	9,313,000
Percent of Sales	5.7%	4.5%	2.8%	4.1%	3.9%
Return on Average Stockholders' Equity	17.4%	12.4%	8.1%	11.7%	10.4%
(Loss) Income Related to Discontinued Businesses	—	(4,488,000)	2,000	(429,000)	274,000
Net Income	$ 19,374,000	$ 8,397,000	$ 8,094,000	$ 10,596,000	$ 9,587,000
Dividends on Preferred and Preference Stock	$ 1,711,000	$ 1,724,000	$ 1,731,000	$ 1,749,000	$ 1,768,000
Average Number of Common and Common Equivalent Shares Outstanding	3,066,830	3,057,246	3,061,165	3,151,348	3,197,389
Primary Earnings Per Share:					
Continuing Operations	$5.76	$ 3.65	$ 2.08	$ 2.94	$ 2.36
Discontinued Businesses	—	(1.47)	—	(.13)	.09
Net Income	5.76	2.18	2.08	2.81	2.45
Average Number of Shares Outstanding—Assuming Full Dilution	4,919,048	4,921,001	4,931,201	5,027,281	5,102,089
Fully Diluted Earnings Per Share:					
Continuing Operations	$3.94	$ 2.62	$ 1.64	$ 2.19	$ 1.83
Discontinued Businesses	—	(.91)	—	(.08)	.05
Net Income	3.94	1.71	1.64	2.11	1.88

Comparative Data

	1976	1975	1974	1973	1972
Capital Expenditures	$ 15,596,000	$ 7,768,000	$ 9,823,000	$ 10,350,000	$ 7,257,000
Depreciation	6,810,000	7,496,000	7,818,000	7,508,000	7,451,000
Working Capital	95,797,000	91,075,000	84,165,000	80,050,000	83,261,000
Current Ratio	2.91	3.03	3.32	3.10	3.75
Long-Term Debt	53,492,000	58,097,000	59,405,000	59,391,000	62,719,000
Stockholders' Equity	119,616,000	104,848,000	100,650,000	96,305,000	91,614,000
Debt-Equity Ratio	.45	.55	.59	.62	.68
Stockholders' Equity Per Share	$25.32	$22.02	$21.08	$19.98	$18.50
Number of Common Stockholders	4,168	4,442	4,431	4,267	3,959
Number of Preferred Stockholders	2,347	2,488	2,564	2,657	2,755
Dividends Per Share of Common Stock	$ .90	$ .80	$ .60	$ .75	$ .60

The operations data for all periods has been reclassified to segregate the operating results and costs of disposal of discontinued businesses from the results of continuing operations. All years have been restated to reflect companies acquired in poolings of interests transactions.

The data for 1974 and subsequent years reflects the last-in, first-out (LIFO) method of inventory valuation for domestic inventories, other than manufacturing supplies. In prior periods, the first-in, first-out (FIFO) method of inventory valuation was followed for all inventory.

Reference is made to Note 3 of Notes to Consolidated Financial Statements for a description of the computation of earnings per share.

Stockholders' equity per share has been calculated by dividing total stockholders' equity at year-end, after deducting the liquidating value of the $1.10 Preferred Stock, by the number of common shares outstanding at year-end assuming full conversion into Common Stock of the outstanding shares of $1.70 Cumulative Convertible Preference Stock.

Management's Discussion and Analysis of the Summary of Operations

The comments following relate to factors causing significant changes in operating results of the Company in the years 1976 and 1975. The Company changed to the last-in, first-out (LIFO) method of inventory valuation for domestic inventories in 1974. Consequently all periods covered in the following discussion reflect comparable inventory valuation but comparison to periods prior to 1974 should give consideration to this change.

In November 1975 the Company decided to discontinue its industrial abrasive and metal stamping businesses which had combined sales of approximately $23 million in 1975 and $26 million in 1974. Accordingly, the accompanying summary of operations for all periods segregates the results of the continuing operations from the discontinued businesses, including the provision in 1975 of $4,500,000 (net of income tax benefits of $4,800,000) for the loss related to the disposal thereof.

Sales revenues in 1976 increased approximately nineteen percent reflecting an increased demand for the Company's products and the general improvement in the economy. Sales revenues from continuing operations declined in 1975 as compared to 1974 reflecting the depressed economy as well as the elimination of marginal items from the Company's product lines. The sales revenues increase in 1976 was particularly strong in the Company's building products group reflecting a significant improvement in the level of housing starts from the extremely depressed levels that existed in 1975. Revenues of the cutting tools group increased moderately in 1976 although still not back to the level of 1974. Revenues of the power components group also increased moderately in 1976 following a strong increase in 1975. A portion of this increase in the revenues of the power components group is the result of the acquisition of Ohio Gear in the early part of 1976. The changes in sales revenues followed economic trends generally and did not reflect any significant favorable or adverse change in market position of the various Divisions of the Company.

The improvement in gross profit and operating income in 1976 is primarily attributable to the increased revenues of the building products group and the increased revenues and greater profitability of the cutting tools group. A portion of the improvement in the profitability of the cutting tools group is attributable to the reduction in their LIFO inventories which resulted in charging to operations the lower costs prevailing in prior years. The power components group had a slight decline in profits in 1976 attributable to product mix related to lack of strength in the capital goods sector of the economy. The improvements in gross profit and operating income in 1975, in spite of the lower overall level of activity, reflect the strength of the industrial gear and heavy duty off-highway equipment segments of the power components group and strength in the metal chimney, fireplace and industrial fiberglass segments of the building products group. In addition, the elimination of marginal items from all product lines and the timely adjustment, where appropriate, of operating costs to reduced levels of demand also contributed to the improvement in overall profit margins.

Pension expense increased in 1976 and 1975 primarily as a result of benefit improvements, including those required to comply with the Employee Retirement Income Security Act which became effective in 1976. Research and development expense increased significantly in 1976, both in absolute amount and as a percent of sales, following a slight increase in 1975 from the 1974 level. The reduced level of activity in 1975 enabled the Company to substantially reduce payroll taxes and maintenance and repair expense. In 1976 these costs were at more normal levels, somewhat above those of 1974.

Interest Expense declined slightly in 1975 and somewhat more in 1976 reflecting the effectiveness of the Company's programs of cost reduction and cash management which is further evidenced in the improved liquidity at year end. As a result, there was no requirement for new borrowings during 1976.

The decline in Other Income, Net in 1976 is the result of greater interest income, reflecting the Company's more liquid position for the entire year, being more than off-set by provision for losses in connection with litigation, claims and the disposal of idle equipment. A number of factors contributed to the Company's having substantial Other Income, Net in 1975 as compared to significant Other Expense, Net in 1974. In 1974 the Company incurred substantial losses in the value of marketable securities and certain other investments whereas in 1975 the marketable securities had a slight increase in value which is reflected in Other Income. In addition, in 1974 certain marginal operations (which did not constitute segments of business as did the major dispositions in 1975) were closed and disposed of at a loss. As a result of the Company's improved liquidity, interest on short-term investments increased significantly in 1975.

The changes in Income from Continuing Operations and the related earnings per share reflect the operating factors referred to above. Net Income (in total and per share) includes the effects of the above factors as well as the operating results of the discontinued businesses and, in 1975, provision for the costs associated with their disposition.

Description of Business

The Company's business is the manufacture and sale of building products, power components and cutting tools.

Building Products

The Company's building products business is the manufacture and sale of plumbing fixtures and supplies and of various sheet metal building products. The plumbing fixtures consist of the *Eljer** brand enameled cast iron, formed steel, vitreous china and fiberglass fixtures for residential and commercial structures. The plumbing fixture line also contains brass faucets and fittings. The Company's sheet metal building products are pre-fabricated all-fuel chimneys and gas vent systems sold principally under the *Metalbestos* tradename, metal fireplaces sold in Canada under the *Selkirk-Metalbestos* and *Acorn* tradenames and metal registers, grills and diffusers for heating and air conditioning systems. The Company also manufactures a line of fiberglass industrial products, the sales of which are included as sales of building products below.

The Company's building products are sold nationally to plumbing and heating, general hardware, building and sheet metal wholesalers. A small proportion is sold directly to contract accounts who purchase the items for resale. The Company also supplies manufacturers of mobile homes and modular housing in the eastern, central and southwestern parts of the United States.

The Company's building products businesses have a significant relationship to building activity, particularly housing construction. Sales of building products and net income attributable thereto increased substantially during 1976 as a result of a higher level of housing starts during 1976 in the United States and Canada.

Power Components

The Company's power components business is the manufacture and sale of internal combustion engine components under the *Schwitzer* tradename, custom industrial gears, splined shafts and racks under the *Illinois Gear* tradename and speed reducers and stock gears under the *Ohio Gear* tradename.

The Company's engine components are turbochargers, air pumps, superchargers, fans, modulated and thermatic fan drives, vibration dampers and water pumps. The products are generally specially designed and engineered and are used in trucks, construction, agricultural and off highway equipment, stationary engines and passenger cars. The Company's customers in the engine components business are most of the major engine manufacturers in these industries. A small proportion of the Company's products are sold to auto parts distributors for resale in replacement and leisure markets.

Sales of all lines of the Company's engine components increased during 1976 over 1975 because of a high level of vehicle production in the automotive, trucking, earthmoving, agricultural and road building equipment industries. Sales were hurt somewhat during the last half of the year due to strikes at certain customers in the automotive and agricultural equipment industries, although the level of sales experienced earlier in the year was restored by year end.

The Company's industrial gear business is the manufacture to customer order of gears, splined shafts and racks for original equipment and replacement markets in a wide variety of industries in the United States, Canada and overseas. The gears are manufactured from steel and bronze forgings and castings. A small number are manufactured from aluminum castings and nonmetallic materials such as nylon and bakelite.

During 1976 the Company purchased a small manufacturer of speed reducers and stock gears whose product is sold to industrial distributors and original equipment manufacturers throughout the United States.

Sales of industrial gears declined during 1976 from the 1975 level because of a lower level of customer capital expenditures, particularly in the steel and mining equipment industries. Sales of speed reducers and stock gears were generally depressed during the eight months of 1976 in which the Company owned the business, although the order intake level of these lines as well as industrial gears was increasing at year end.

Cutting Tools

The Company's cutting tools business is the manufacture and sale of circular and band saws, hacksaws, machine knives, circular cutters, shears, knives, creasing and perforating tools and files under the *Simonds* tradename, precision ground solid carbide tools and burs under the *Atrax* tradename and carbide tipped masonry drills under the *Newcarb* tradename.

The Company's cutting tools products are sold nationally, primarily to industrial supply and other wholesale outlets, although the Company makes some sales on a contract basis to end users. Sales of cutting tools manufactured by the Company are generally related to the level of manufacturing activity in the economy and were strong during 1976.

The Company also manufactures under the *Simonds* tradename alloy steels such as high quality alloy,

*The italicized product names are ® trademarks of the Company.

stainless, high nickel, controlled expansion alloy, magnetic alloy and tool and specialty steels in plates, sheets, bands, cold rolled strips and bars. A significant portion of the Company's steel production is used to supply tool steel to cutting tools operations of the Company in the United States and Canada. Sales of the Company's alloy steels business declined during 1976. However, net income of the Company's steel business increased substantially during 1976 over 1975 because the resulting product mix included a higher proportion of more profitable lines and because of a LIFO inventory reduction.

Acquisition of Hydrometals Inc.

In January, 1977 the Company announced a tender offer for all the issued and outstanding stock of Hydrometals, Inc., and by February 16, 1977 had purchased 85 percent of the common stock and 47 percent of the $.60 Cumulative Convertible Preferred Stock of Hydrometals. The offer has been extended to February 22, 1977. Hydrometals is a manufacturer of plumbing hardware, hand tools and consumer electronics, with sales of $120,988,000 and net income of $6,021,000 in its 1976 fiscal year ended September 30.

Foreign Operations

Approximately 13% of the sales and 7% of the income from continuing operations before income taxes of the Company during 1976 came from foreign manufacturing operations in Canada, Europe and Brazil.

The Company's Canadian operations consist of the manufacture and sale under the *Simonds* tradename of the Company's entire line of cutting tools except files and carbide tools, of prefabricated metal chimneys, gas vent systems, metal fireplaces, Franklin stoves, registers, grills and diffusers, principally under the *Acorn* and *Selkirk-Metalbestos* trademarks, and of vibration dampers under the *Schwitzer* tradename.

The Company's Common Market operations consist principally of the manufacture of the Company's gas vent and prefabricated metal chimney line at a plant in England and the sale of such products throughout Europe. The Company also has a United Kingdom operation for the sale and service of turbochargers in Europe.

The Company has a Brazilian subsidiary which is engaged in the manufacture and service of turbochargers manufactured under license from the Company.

Export Sales and License Revenues

The Company had export sales during 1976 of $9,110,000, principally of cutting tools and power components. The Company also licenses turbochargers, vibration dampers, fan drives and fans to various licensees in England, West Germany, Poland, Japan, Brazil and Mexico.

Discontinued Businesses

In 1975, the Company announced the discontinuance of operations in the abrasives and metal stampings businesses, and has since disposed of all its operations in these industries.

Allocation of Sales and Income Among Business Lines

The following table shows, for each of the Company's fiscal years 1972 through 1976, respectively, percentages of (i) the total net sales and (ii) the total income from continuing operations before income taxes of the Company and its subsidiaries attributable to each of the above described lines of business.

	Percentage (Approximate) of Net Sales				
Line of Business	1972	1973	1974	1975	1976
Building Products	40	37	33	34	36
Power Components	25	24	26	32	31
Cutting Tools	35	39	41	34	33

	Percentage (Approximate) of Income From Continuing Operations Before Income Taxes				
Line of Business	1972	1973	1974	1975	1976
Building Products	46	35	29	32	33
Power Components	25	26	34	55	37
Cutting Tools	29	39	37	13	30

The high percentage of income of the power components business during 1975 and the low percentage of income of the cutting tools business during that year were due to a favorable product mix and high profitability of industrial gears and heavy duty off-highway equipment components, and to low profitability resulting from low volume in the Company's cutting tools business.

Product Line Information

The only product lines of the Company which contributed more than 10% of the Company's sales during either of the fiscal years 1975 or 1976 are the Company's plumbingware and industrial gear lines. The following table shows, for each of the Company's fiscal years 1972 through 1975, the approximate percentage of the Company's total sales contributed by these plumbingware and industrial gear lines.

	1972	1973	1974	1975	1976
Plumbingware	27%	23%	18%	17%	20%
Industrial Gears	5%	6%	7%	11%	9%

General Information

Properties. The Company and its subsidiaries operate 29 plants in the United States, Canada, the United Kingdom and Brazil.

Research and Development. During 1975 and 1976, the Company expended $2,900,000 and $4,000,000, respectively, on research and development activities, most of which were related to the Company's engine components business.

Environmental Protection Laws. The Company is undertaking a number of capital expenditure projects to comply with applicable rules and regulations governing the discharge of materials into the environment, and expended $2,180,000 for such purposes during 1976.

Information on Voting Stock

The Company's classes of stock which are entitled to vote at Annual Meetings of Stockholders are the $1.70 Cumulative Convertible Preference Stock and Common Stock. Information on the market prices of, and dividends paid with respect to, such classes of stock is included in this section.

$1.70 Cumulative Convertible Preference Stock. The $1.70 Cumulative Convertible Preference Stock is traded on the New York Stock Exchange. The high and low sales prices of the shares on the New York Stock Exchange, by quarter, for the years 1975 and 1976 are as follows:

	1975		1976	
	High	Low	High	Low
First Quarter	20½	16	30	22⅜
Second Quarter	22	20	33	30
Third Quarter	21⅜	17¼	32	29
Fourth Quarter	22¾	18⅜	37½	31¼

The $1.70 Cumulative Convertible Preference Stock is entitled to a preferential quarterly dividend of 42½¢ per share. The dividend has been paid during each quarter since the stock was issued on September 1, 1965.

Common Stock. The Common Stock is traded on the New York Stock Exchange. The high and low sales price of the shares on the New York Stock Exchange, by quarter, for the years 1975 and 1976, are as follows:

	1975		1976	
	High	Low	High	Low
First Quarter	9	6	19½	11½
Second Quarter	10½	7⅞	20	17⅜
Third Quarter	10⅝	8⅝	18⅞	16⅞
Fourth Quarter	12¼	8½	22½	17

The Company paid a quarterly dividend of 15¢ per share on the Common Stock from the fourth quarter of 1970 through the third quarter of 1975, a quarterly dividend of 20¢ per share from the fourth quarter of 1975 through the second quarter of 1976, and a quarterly dividend of 25¢ per share since third quarter of 1976. The Company also paid a special year end dividend of 15¢ per share in 1973 and 1975.

Consolidated Statements of Income

Wallace Murray Corporation and Subsidiaries

For the Years Ended January 2, 1977 (Fiscal 1976)
and December 28, 1975 (Fiscal 1975)

	1976	1975
Net Sales	$337,327,000	$283,563,000
Cost of sales	254,960,000	220,282,000
Gross Profit	82,367,000	63,281,000
Selling, general and administrative expenses	40,855,000	34,700,000
Operating Income	41,512,000	28,581,000
Interest expense	4,563,000	4,650,000
Interest income	(1,474,000)	(866,000)
Other (income) expense, net	649,000	(588,000)
	3,738,000	3,196,000
Income from Continuing Operations Before Income Taxes	37,774,000	25,385,000
Income taxes (Note 1):		
Federal	14,800,000	9,700,000
State	2,700,000	1,850,000
Foreign	900,000	950,000
	18,400,000	12,500,000
Income from Continuing Operations	19,374,000	12,885,000
Loss related to discontinued businesses (Note 2)	—	4,488,000
Net Income	$ 19,374,000	$ 8,397,000
Primary Earnings per Share (Note 3):		
Continuing Operations	$5.76	$3.65
Discontinued Businesses	—	(1.47)
Net Income	$5.76	$2.18
Fully Diluted Earnings per Share (Note 3):		
Continuing Operations	$3.94	$2.62
Discontinued Businesses	—	(.91)
Net Income	$3.94	$1.71

The accompanying notes to consolidated financial statements are an integral part of these statements.

Consolidated Balance Sheets

January 2, 1977 (Year-End Fiscal 1976) and December 28, 1975

Assets	1976	1975
Current Assets:		
Cash (including temporary cash investments of $24,045,000 in 1976 and $19,214,000 in 1975, at cost which approximates market)	$ 25,581,000	$ 20,727,000
Marketable securities (Note 1)	1,443,000	1,293,000
Accounts receivable, less allowances of $1,650,000 in 1976 and $1,250,000 in 1975	46,351,000	39,267,000
Inventories (Note 1)	70,977,000	65,269,000
Prepaid expenses	1,622,000	954,000
Net assets of discontinued businesses (Note 2)	—	8,350,000
Total current assets	145,974,000	135,860,000
Plant and Equipment, at cost:		
Land	3,793,000	3,637,000
Buildings	45,285,000	41,306,000
Machinery and equipment	103,461,000	93,965,000
	152,539,000	138,908,000
Less—Accumulated depreciation	82,431,000	76,950,000
	70,108,000	61,958,000
Funds Held by Trustee for Plant Construction	1,354,000	2,750,000
Other Assets, at cost	1,153,000	1,289,000
Intangibles (Note 1)	7,513,000	7,513,000
	$226,102,000	$209,370,000

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

Liabilities and Stockholders' Equity	1976	1975
Current Liabilities:		
Current portion of long-term debt and notes payable	$ 4,655,000	$ 4,631,000
Accounts payable	10,974,000	13,000,000
Accrued payrolls and employee benefits	15,950,000	13,053,000
Accrued taxes	10,588,000	7,560,000
Other accrued liabilities	7,181,000	6,541,000
Net liabilities of discontinued businesses (Note 2)	829,000	—
Total current liabilities	50,177,000	44,785,000
Long-Term Debt (Notes 4 and 6):		
6½ % Senior Notes, payable through 1988	24,600,000	26,800,000
6⅞ % Subordinated Notes, payable through 1988	7,710,000	8,370,000
6½ % Convertible Subordinated Debentures, due 1979-1991	8,411,000	8,470,000
6%-8½ % Capitalized Long-Term Lease Commitments, payable through 1995	8,445,000	8,840,000
Notes to Banks, payable through 1984	3,165,000	4,315,000
6½ % Subordinated Debentures, due 1978-1981	997,000	1,039,000
5¼ % Mortgage Note, payable through 1985	164,000	263,000
	53,492,000	58,097,000
Deferred Income Taxes (Note 1)	2,817,000	1,640,000
Stockholders' Equity (Notes 1, 4, 5 and 6):		
$1.10 Cumulative Preferred Stock	4,849,000	5,101,000
$1.70 Cumulative Convertible Preference Stock	6,328,000	6,361,000
Common Stock	11,501,000	11,465,000
Capital Surplus	3,015,000	2,904,000
Retained Earnings	93,923,000	79,017,000
Total Stockholders' Equity	119,616,000	104,848,000
	$226,102,000	$209,370,000

Consolidated Statements of Changes in Financial Position

For the Years Ended January 2, 1977 (Fiscal 1976) and December 28, 1975 (Fiscal 1975)

	1976	1975
Source of Funds		
Income from continuing operations	$ 19,374,000	$ 12,885,000
Loss related to discontinued businesses	—	4,488,000
Net income	19,374,000	8,397,000
Add items not requiring outlay of working capital		
Depreciation	6,810,000	7,496,000
Deferred income taxes	1,177,000	633,000
Total from operations	27,361,000	16,526,000
Proceeds from long-term debt	—	3,300,000
Withdrawal (deposit) of funds held by trustee	1,396,000	(2,750,000)
Disposal of plant and equipment (including in 1975, $5,900,000 applicable to discontinued businesses)	636,000	6,212,000
Other, net	156,000	197,000
	29,549,000	23,485,000
Application of Funds		
Additions to plant and equipment	15,596,000	7,768,000
Dividends paid	4,468,000	4,170,000
Reduction of long-term debt	4,605,000	4,608,000
Purchase of treasury stock	158,000	29,000
	24,827,000	16,575,000
Increase in Working Capital	$ 4,722,000	$ 6,910,000
Changes in Working Capital		
Increase (Decrease) in Current Assets:		
Cash	$ 4,854,000	$ 15,283,000
Marketable securities	150,000	175,000
Accounts receivable	7,084,000	(1,860,000)
Inventories	5,708,000	(6,446,000)
Prepaid expenses	668,000	(75,000)
Net assets of discontinued businesses	(8,350,000)	8,350,000
	10,114,000	15,427,000
Increase (Decrease) in Current Liabilities:		
Current portion of long-term debt and notes payable	24,000	716,000
Accounts payable	(2,026,000)	3,127,000
Accrued taxes	3,028,000	3,282,000
Payrolls and other accruals	3,537,000	1,392,000
Net liabilities of discontinued businesses	829,000	—
	5,392,000	8,517,000
Increase in Working Capital	$ 4,722,000	$ 6,910,000

The accompanying notes to consolidated financial statements are an integral part of these statements.

Consolidated Statements of Stockholders' Equity

Wallace Murray Corporation and Subsidiaries

For the Years Ended January 2, 1977 (Fiscal 1976) and December 28, 1975

	Capital Stock				
	Preferred Stock (a)	Preference Stock (b)	Common Stock (c)	Capital Surplus	Retained Earnings (Note 4)
Balance, December 29, 1974	$ 5,160,000	$ 6,361,000	$11,465,000	$ 2,874,000	$74,790,000
Net income					8,397,000
Purchase of 2,956 Shares of Preferred Stock	(59,000)			30,000	
Cash dividends:					
Preferred and Preference Stock					(1,724,000)
Common Stock ($.80 per share)					(2,446,000)
Balance, December 28, 1975	5,101,000	6,361,000	11,465,000	2,904,000	79,017,000
Net income					19,374,000
Purchase of 12,559 Shares of Preferred Stock	(252,000)			94,000	
Conversion of 4,359 Shares of Preference Stock into 7,557 Shares of Common Stock		(33,000)	28,000	5,000	
Exercise of options to purchase 2,200 Shares of Common Stock			8,000	12,000	
Cash dividends:					
Preferred and Preference Stock					(1,711,000)
Common Stock ($.90 per share)					(2,757,000)
Balance, January 2, 1977	$ 4,849,000	$ 6,328,000	$11,501,000	$ 3,015,000	$93,923,000

Shares as of January 2, 1977:	Preferred Stock (a)	Preference Stock (b)	Common Stock (c)
Authorized	426,177	1,416,456	12,000,000
Outstanding (d)	242,473	843,714	3,067,003
Treasury	52,807	14,202	353,701

(a) $1.10 Cumulative Preferred Stock, no par value, stated at $20.00 per share
(b) $1.70 Cumulative Convertible Preference Stock, no par value, stated at $7.50 per share
(c) Common Stock, $3.75 par value
(d) All balances are net of treasury shares

The accompanying notes to consolidated financial statements are an integral part of these statements.

Notes to Consolidated Financial Statements
January 2, 1977

1. Summary of Significant Accounting Policies

Fiscal Year: The Company maintains its accounts on a 52-53 week fiscal year ending on the Sunday nearest December 31. The 1976 fiscal year, which ended on January 2, 1977, consisted of 53 weeks.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and all subsidiaries. All significant intercompany transactions have been eliminated. Intangibles, which represent the cost of investments in businesses acquired prior to November 1, 1970 in excess of amounts assigned to tangible assets, are not being amortized. In the opinion of management, there has been no diminution in value.

Translation of Foreign Currencies: Assets and liabilities of foreign subsidiaries are translated into U.S. dollars at year-end exchange rates, except that inventories and plant and equipment are translated at rates prevailing at dates of acquisition. Income and expense items (other than charges relating to balance sheet items translated at historical rates) are translated at the average rates of exchange prevailing during the year. Translation gains and losses, which are immaterial, are included in income currently.

Inventories: Inventories are stated at the lower of cost or market. The cost of domestic inventories, other than manufacturing supplies, was determined on the basis of the last-in, first-out (LIFO) method of inventory accounting. Inventories for which the cost was determined by the LIFO method of accounting totaled $55,784,000 and $51,412,000 at January 2, 1977 and December 28, 1975, respectively. During 1976, the reduction of certain LIFO inventories resulted in charging to operations the lower costs prevailing in prior years, the effect of which was to increase net income by approximately $1,000,000. If the first-in, first-out (FIFO) method of inventory accounting had been used, inventories would have been $25,103,000 and $20,315,000 higher than reported at January 2, 1977 and December 28, 1975, respectively. The cost of foreign inventories and domestic manufacturing supplies was determined on the basis of the FIFO method of inventory accounting.

Marketable Securities: Marketable securities are stated at market value which does not exceed cost of $1,864,000 at January 2, 1977 and $2,713,000 at December 28, 1975. The income statement includes gains of $376,000 in 1976 and $175,000 in 1975, reflecting the changes in market values during those years.

Research and Development Costs: Expenditures for research and development, which amounted to approximately $4,000,000 in 1976 and $2,900,000 in 1975, are charged to income in the year incurred.

Depreciation: Depreciation is computed principally on the straight-line method for financial reporting purposes and on accelerated methods for tax purposes.

Income Taxes: Income tax expense includes deferred Federal income taxes ($1,177,000 in 1976 and $633,000 in 1975) which are primarily attributable to the use of accelerated depreciation for tax purposes. Investment tax credits ($600,000 in 1976 and $550,000 in 1975) are recorded as a reduction of the provision for Federal income taxes in the year in which the related assets are placed in service. Federal and foreign taxes on income, prior to reduction for the investment tax credit, approximate the U.S. statutory income tax rate.

U.S. income taxes have not been provided on unremitted earnings of subsidiaries operating outside the United States (principally in Canada) since such earnings are permanently invested in those operations and are not expected to be remitted to the Company.

Pensions: The Company and its subsidiaries have a number of pension plans covering substantially all of their employees. The total pension expense was $8,650,000 in 1976 and $7,365,000 in 1975. The increase in pension expense is primarily due to benefit improvements, including those required to comply with the Employee Retirement Income Security Act which became effective in 1976. The Company's policy is to fund pension costs accrued, including amortization of prior service costs over periods of 20 to 30 years. With respect to certain of the plans, the actuarially computed value of vested benefits as of the most recent actuarial review, December 28, 1975, exceeded the total market value of the applicable pension funds by approximately $29,000,000. In 1976 the market value of these funds increased by approximately $11,000,000.

2. Discontinued Businesses

In November 1975, the Company decided to discontinue its industrial abrasive and metal stamping businesses and a provision of $4,500,000 (net of income tax benefits of $4,800,000) was made for the estimated losses on the disposal of these discontinued businesses. The results of operations for 1975, which are included in the loss related to discontinued businesses, were essentially break even on sales of $23,005,000. Substantially all of the assets have been disposed of. It is anticipated that the remaining matters relating to these discontinued businesses will be resolved during 1977 at no additional loss.

Net (liabilities) assets of discontinued businesses at January 2, 1977 and at December 28, 1975 are as follows:

	1976	1975
Estimated net realizable value of assets designated for disposition	$ 860,000	$9,300,000
Less: Existing liabilities of discontinued businesses	—0—	(1,250,000)
Estimated costs of discontinuance	(3,945,000)	(4,500,000)
	(3,085,000)	3,550,000
Related income tax benefit	2,256,000	4,800,000
Net (Liabilities) Assets of Discontinued Businesses	$ (829,000)	$8,350,000

3. Earnings Per Share

Primary earnings per share were computed by dividing net income, after deducting all preferred and preference dividends, by the average number of common and common equivalent shares outstanding during the period. Common equivalent shares are those issuable upon the exercise of stock options, when dilutive, net of shares assumed to have been repurchased with the proceeds.

Fully diluted earnings per share have been computed as above with the additional assumption of the full conversion into Common Stock of the outstanding convertible securities together with the elimination of the related dividend and interest deductions.

4. Long-Term Debt and Credit Arrangements

The Company's indebtedness to various banks bears interest at rates ranging from ⅜% to 1½% above the applicable prime rates of the banks.

The Company has agreements and understandings with several banks whereby it may borrow an additional $35,000,000 at rates ranging from the prime rate to 125% of the prime rate. The Company pays ½% per annum commitment fee on $25,000,000 of these commitments. Informal arrangements require the Company to maintain compensating balances ranging from $2,000,000 to $4,000,000, dependent upon the portion of the commitments utilized.

Under the most restrictive provisions of the long-term debt agreements, retained earnings of $21,948,000 were unrestricted as to the payment of cash dividends or repurchase of stock as of January 2, 1977. The agreements and the Company's Certificate of Incorporation also contain various other restrictions.

Maturities of long-term debt over the next five years are as follows: 1977—$4,448,000; 1978—$4,689,000; 1979—$4,720,000; 1980—$4,041,000 and 1981—$4,272,000.

5. Stock Options

At January 2, 1977, options to purchase 56,100 shares of Common Stock were outstanding and exercisable at prices ranging from $14.375 to $22.00 per share (aggregate price of $1,017,712). During 1976, options to purchase 2,200 shares of Common Stock were exercised at prices ranging from $8.8125 to $14.375 per share (aggregate price of $20,500) and options to purchase 74,050 shares at an aggregate price of $1,472,562 lapsed. In addition, as of January 2, 1977, 67,750 shares of Common Stock were reserved for options which may be granted under a Qualified Stock Option Plan for Officers and Other Key Employees. Options granted under this Plan will be exercisable during the five-year period subsequent to date of grant, at prices not less than market prices on the date such options are granted.

6. Capital Stock

The $1.70 Cumulative Convertible Preference Stock is of equal rank with the $1.10 Cumulative Preferred Stock in preference as to dividends and payments upon liquidation.

In the event of liquidation or dissolution, the $1.70 Cumulative Convertible Preference Stock will also be entitled to share ratably with the Common Stock on a share-for-share basis in the assets after payment of all preferential distributions if the liquidation is voluntary (subject to right of redemption) or, if the liquidation is involuntary, to share ratably with the Common Stock up to a limit of $30.00 per share (in addition to a $7.50 per share preferential distribution). Had involuntary liquidation taken place as of January 2, 1977, and based upon the accompanying balance sheet values as of that date, the holders of the $1.70 Cumulative Convertible Preference Stock would have been entitled to receive an amount of $29,718,000, which amount includes the stated value of such stock. Each share of the $1.70 Cumulative Convertible Preference Stock is convertible into 1.7356 shares of Common Stock. Had all such shares been converted as of January 2, 1977, and based upon the accompanying balance sheet as of that date, their total equity would have been $37,093,000. The $1.70 Cumulative Convertible Preference Stock is redeemable as a whole or in part at $35.00 a share (plus accrued dividends).

The $1.10 Cumulative Preferred Stock is redeemable at prices (plus accrued dividends) declining from $20.21

per share on January 2, 1977 to $20.00 per share on July 2, 1979 and thereafter. Each year the Company is required to retire 9,228 shares of the $1.10 Cumulative Preferred Stock.

An additional 1,000,000 shares of Preferred Stock with no par value have been authorized; no shares have been issued under this authorization.

Shares of Common Stock were reserved for future issuance at January 2, 1977, as follows:

Conversion of $1.70 Cumulative Convertible Preference Stock	1,464,350
Conversion of 6½% Convertible Subordinated Debentures at the rate of 45.455 shares for each $1,000 principal amount	382,322
Exercise of stock options	123,850
	1,970,522

7. Rental Commitments

Annual rental expense for 1976 and 1975 was $3,770,000 and $3,362,000, respectively. Minimum annual rental commitments for non-cancellable leases with a duration of one year or more are as follows:

	Buildings and Leaseholds	Machinery and Equipment	Total
1977	$ 910,000	$1,541,000	$2,451,000
1978	890,000	1,193,000	2,083,000
1979	610,000	1,085,000	1,695,000
1980	551,000	467,000	1,018,000
1981	526,000	229,000	755,000
1982-86	1,203,000	86,000	1,289,000
1987-91	174,000	—	174,000
1992-96	37,000	—	37,000
1997 to expiration	155,000	—	155,000
Totals	$5,056,000	$4,601,000	$9,657,000

In addition, the company leases other equipment and facilities on a month-to-month basis at various locations. The terms of these leases provide that the Company may cancel them upon 10 to 90 days notice. The annual rental expense associated with these leases amounted to approximately $1,000,000 in 1976 and $1,400,000 in 1975.

8. Litigation

The Company is subject to various pending lawsuits and claims relating to various matters arising out of the conduct of the Company's business. In the opinion of management, the ultimate outcome of these lawsuits and claims will not have a material adverse effect on the consolidated financial position of the Company and its subsidiaries.

9. Quarterly Financial Data (Unaudited)

The table below sets forth the summarized quarterly financial data (in thousands of dollars, except for per share amounts) for the fiscal year 1976:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net Sales	$77,261	$83,234	$83,102	$93,730
Gross Profit	$17,719	$19,045	$20,300	$25,303
Net Income	$ 3,649	$ 4,768	$ 4,653	$ 6,304
Primary Earnings per Share	$ 1.05	$ 1.42	$ 1.38	$ 1.91
Fully Diluted Earnings per Share	$ .74	$ .97	$ .95	$ 1.28

10. General Description of the Impact of Inflation (Unaudited)

A substantial portion of the dollar increase in consolidated net sales is attributable to higher selling prices required to recover escalating product costs. In recent years the Company has been able to recover these inflationary product cost increases through increased sales prices and greater operating efficiencies.

Replacing items of plant and equipment with assets having equivalent productive capacity has usually required a substantially greater capital investment than was required to purchase the assets which are being replaced. The additional capital investment primarily reflects the cumulative impact of inflation on these assets given their long-lived nature.

The Company's annual report on Form 10-K (a copy of which is available upon request) contains specific information with respect to fiscal year-end 1976 replacement costs of inventory and productive capacity (generally buildings, machinery and equipment) and the approximate effect which replacement costs would have had on cost of sales and depreciation expense for the year.

11. Acquisition Subsequent to Balance Sheet Date

On January 27, 1977, the Company, having purchased 350,000 shares of common stock of Hydrometals, Inc., announced a cash tender offer for any and all shares of Hydrometals common and preferred stock. Acquisition of 100% of Hydrometals under the terms of the tender offer would involve an expenditure of approximately $50,000,000, which is expected to be financed from available internal funds and additional borrowings. For a further discussion of this acquisition, see the letter to shareholders.

Auditors' Report

Arthur Andersen & Co.
New York, N.Y. 10019

To the Stockholders and the Board of Directors,
Wallace Murray Corporation:

We have examined the consolidated balance sheets of Wallace Murray Corporation (a Delaware corporation) and subsidiaries as of January 2, 1977 and December 28, 1975, and the related consolidated statements of income, stockholders' equity and changes in financial position for the fiscal years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Wallace Murray Corporation and subsidiaries as of January 2, 1977 and December 28, 1975, and the results of their operations and the changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

February 3, 1977.

Operating Groups

Building Products

Eljer Plumbingware

Thomas H. Valdes
Vice President-General Manager

Division Office: Pittsburgh, Pa.

Plants: Ford City, Pa.; Marysville, and Salem, O.; and Tupelo, Miss.

Products: Plumbing systems and fixtures including enameled cast iron and formed steel products, vitreous china, fiberglass and brass fittings.

Lawton-Scharf

Bob G. Bunday
Vice President-General Manager

Division Office: St. Petersburg, Fla.

Distributing Branches: Americus, Ga.; Elkhart, Ind.; Tupelo, Miss.; and Waco, Tex.

Products: Plumbing supplies and building components for the mobile home industry.

Selkirk Metalbestos—Europe

Robert J. Loveless
Vice President-General Manager

Division Office: London, England.

Plant: Barnstaple, England.

Products: Gas vent systems, chimney systems, and industrial chimneys.

Selkirk Metalbestos—Canada

Samuel J. McCullough
Vice President-General Manager

Division Office: Brockville, Ontario.
Plants: Brockville, Oshawa and Toronto, Ontario.

Products: Gas vent systems, chimney systems, industrial chimneys, freestanding and built-in fireplaces, and Franklin stoves.

Fiberglass Products

Robert L. Whiteman
Vice President-General Manager

Division Office: Wilson, N.C.

Plant: Wilson, N.C.

Products: Fiberglass tubs, shower stalls, pipes, tanks, exhaust systems and custom molding.

Metalbestos Systems

Donald D. Disotell
Vice President-General Manager

Division Office: Belmont, Calif.

Plants: Nampa, Id. and Logan, O.

Products: Gas vent systems and prefabricated chimneys.

Dry Manufacturing

Hal S. Dry
Vice President-General Manager

Division Office: Winters, Tex.

Plant: Winters, Tex.

Products: Registers, grills and diffusers for heating and air-conditioning.

Power Components

Schwitzer Engineered Components

Carol E. Hamilton
Vice President-General Manager

Division Office: Indianapolis, Ind.

Plants: Indianapolis and Elwood, Ind.; Rolla, Mo.; Stratford, Ontario; and Campinas, Brazil.

Products: Automotive and diesel engine components including turbochargers, cooling fans, vibration dampers and fan drives.

Illinois Gear

John Allwood
Vice President-General Manager

Division Office: Chicago, Ill.

Plant: Chicago, Ill.

Products: Metallic and non-metallic custom-made industrial gears.

Ohio Gear

M. K. Sieber
Vice President-General Manager

Division Office: Liberty, S.C.

Plant: Liberty, S.C.

Products: Stock speed reducers and stock gears.

Cutting Tools

Simonds Cutting Tools

W. Burke Bero
Vice President-General Manager

Division Office: Fitchburg, Mass.

Plants: Fitchburg, Mass.; Newcomerstown, O.; Portland, Ore.; and Shreveport, La.

Products: Circular band and hack saws, files, machine knives, circular cutters and steel specialties.

Simonds Cutting Tools, Canada

John C. Orr
Vice President-General Manager

Division Office: Granby, Quebec

Plants: Granby, Quebec and Vancouver, B.C.

Products: Saws and machine knives.

Simonds Steel

Charles H. Emery
Vice President-General Manager

Division Office: Lockport, N.Y.

Plant: Lockport, N.Y.

Products: Custom-made high quality alloy, tool and specialty steels.

Atrax Carbide Products

John C. Fritz
Vice President-General Manager

Division Office: Newington, Conn.

Plants: Newington, Conn.

Products: Precision solid carbide tools and burs.

Atrax Cemented Carbide

John C. Fritz
Vice President-General Manager

Division Office: McKeesport, Pa.

Plant: McKeesport, Pa.

Products: Carbide and carbide products.

New England Carbide Tool

Evert Tengberg
Vice President-General Manager

Division Office: Peabody, Mass.

Plant: Peabody, Mass.

Products: Carbide-tipped masonry bits, abrasive wheels, electric hammers and special carbide tools.

International Subsidiaries and Affiliates

Wallace-Murray Canada Limited

Wallace-Murray France S.A.R.L.

Wallace-Murray Limited (England)

Wallace-Murray G.m.b.H. (Germany)

Lacom Componentes Industriais S.A. (Brazil)

Wallace Murray Corporation

Executive Office
299 Park Avenue
New York, New York 10017

Directors

John D. Ames, Jr.▪•
President
Ames Investment Management Service
135 S. LaSalle Street
Chicago, Illinois 60603

Charles H. Dyson*†
Chairman of the Board
The Dyson-Kissner Corporation
230 Park Avenue
New York, New York 10017

Gerard A. Fulham
Chairman of the Board
Pneumo Corporation
4800 Prudential Tower
Boston, Massachusetts 02199

Franklin H. Kissner*★
Director
The Dyson-Kissner Corporation
230 Park Avenue
New York, New York 10017

James A. McLean•
Vice President
The Dyson-Kissner Corporation
One Washington Mall
Boston, Massachusetts 02108

John A. Moran▪
President
The Dyson-Kissner Corporation
230 Park Avenue
New York, New York 10017

Charles V. Myers*
President
Wallace Murray Corporation
299 Park Avenue
New York, New York 10017

Robert E. Palmer•†
Senior Vice President
Reynolds Securities, Inc.
120 Broadway
New York, New York 10005

James O. Wright▪
Box 171
Sea Island, Georgia 31561

Officers

Charles V. Myers
President and Chief Executive Officer

Richard D. Castle
Senior Vice President—Finance

Richard L. Durgin
Group Vice President
Power Components

Harold R. Falkner
Group Vice President
Building Products

Robert J. Niehaus
Group Vice President
Cutting Tools

Joseph A. Abbott
Vice President
Corporate Communications

David G. McNamara
Controller

Fred W. Peters
Treasurer

Robert A. Sherman
General Counsel and Secretary

The Dyson-Kissner Corporation is a private investment company with manufacturing and distribution operations and substantial investments in a number of businesses. Ames Investment Management Service, of which Mr. Ames is President, is a registered investment advisor. Pneumo Corporation, of which Mr. Fulham is Chairman and Chief Executive Officer, operates wholesale and retail food distribution businesses, and designs and manufactures aircraft and industrial components. Reynolds Securities, Inc., of which Mr. Palmer is Senior Vice President, is engaged in the business of investment banking and securities brokerage. Mr. Wright is engaged in the management of personal investments. All officers of Wallace Murray Corporation are located at 299 Park Avenue, New York, N.Y. 10017.

Transfer, Registrar and Disbursing Agent

Citibank, N.A.
111 Wall Street, New York, N.Y. 10015
Common Stock—
$1.70 Cumulative Convertible Preference Stock—
$1.10 Cumulative Preferred Stock—
6½% Convertible Subordinated Debentures—

Auditors

Arthur Andersen & Co.
1345 Avenue of the Americas
New York, N.Y. 10019

The annual meeting of the Corporation will be on April 28, 1977 at Wilmington, Delaware at 12 Noon.

---

* Member of Executive Committee
★ Chairman of the Board
† Member of the Finance Committee
▪ Member of the Audit Committee
• Member of the Personnel Committee

Annual Report Design: Arnold Saks, Inc.
Text: Mark Strage
Major Photography: Joel Meyerowitz
Other Photography: Burt Glinn, Magnum;
Burk Uzzle, Magnum

Wallace Murray Corporation
299 Park Avenue
New York, New York 10017

WallaceMurray